

Starting Out or Starting Over

Unfortunately Credit 101 is not a class they offer in high school or college, although in this day and age it should be. So what should a college student know before they embark on a journey of establishing credit? If they stick by the basics and practice a little discipline it should be enough to keep them out of trouble. These same principles apply to anyone who is “starting over” or who may be coming out of bankruptcy, divorce or any other credit effecting circumstance.

According to statistics, the average college student now graduates with credit card debt of \$5,000 - \$8,000. In addition to student loans, the graduate could be paying off debt for a very long time, and this is before they make any of life’s major purchases such as a home. Hopefully this statistic will change due to the new credit cards laws which prohibit credit card companies from soliciting college students.

Establishing credit as a young adult is a good idea and can pave the way for good credit and credit scores when it’s time to make a big purchase. But it is important to utilize credit to work for and not against them. Having a credit card for emergencies is smart, but the newest CD by their favorite band or pizza at midnight does not constitute an emergency. Also having a credit card with a \$300 limit does not mean they actually have \$300. If only the minimum payment is made, you will spend closer to \$500 or \$600 to pay off the balance.

As of last February under the new credit card protection act, no one under 21 can receive a credit card unless they have a cosigner or they can provide financial information indicating they have the ability to independently repay the debt. However, there are still several ways a young person can establish credit. A parent can add their child as an authorized user to one of their existing credit cards. The parent does not give the child use of the card, but the child will “inherit” the credit rating. In the case of starting over an individual could be added as an authorized user by a spouse to a card with a good history.

A secured credit card is another way to establish credit. A creditor, such as a bank or credit union, gives the borrower a credit card or line of credit secured by a savings account. The card holder makes monthly payments on the outstanding balance similar to a normal credit card. Once the cardholder has established a good payment history with the creditor (usually 12 - 18 months) they can often upgrade the card to an unsecured card. Since it is a secured account some creditors will not require the borrower to be over 21. A good place to shop for and compare secured cards is www.bankrate.com.



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What about other types of credit? When you open an account for almost anything now your credit will be checked. This includes cell phones, auto loans, student loans, utilities, insurance, etc. If you have no established credit they may require a cosigner or deposit. The rate you pay on almost everything is based on the 3 digit FICO score. Even the cost of your health and auto insurance is affected by your FICO score.

Once a person has established or reestablished credit, it is very important to maintain it. Rule number one is to pay your bills on time. One 30 day late payment on any account could drop a FICO score as much as 100 points and the late payment will remain on your credit for 7 years! Even though cell phones, utilities and insurance don't actually report to the credit bureaus, if you fail to make payments they will turn you over to a collection agency that usually does. As with a late payment, a collection will stay on your report for 7 years.

With credit cards it is always the best practice to pay them off every month so as not to incur finance charges. If this is not possible, at a very minimum keep the balances on revolving debt below 30% of the high credit. For example, if you have a credit card with a \$300 limit keep the balance below \$90. The higher the percentage of the balance, the more it will negatively affect your FICO score. And the lower your FICO score the more you pay in interest rates and fees. Additionally, once you've established a few credit cards, don't close them. The goal is to establish a long payment history.

Obtaining and managing credit doesn't have to be difficult. Whether you are starting out or starting over, a few rules and a little discipline can lay the foundation for a good credit history, which is one of the most important assets you can have.

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